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THE HOLDING COMPANY CONCEPT
APPLIED TO
MULTIPLE AUTOMOBILE DEALERSHIPS

by

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Introduction

Ownership and operation of more than one automobile dealership and the resulting possible financial rewards have been made difficult to attain in recent years. This difficulty has been especially harmful to those dealers in areas of population which are considerably less dense than the metropolitan areas. These smaller dealers cannot amass the large sales and profit potential available to the dealers in the metropolitan areas. It can then be to their benefit to develop some arrangement in which they can circumvent the problems and obstacles which have arisen to block a multiple dealership operation. This report will deal with these problems and suggest a possible solution to them. The situation dealt with will be limited to a small business application. It will be pointed toward the ownership of several dealerships which would not be located in metropolitan areas. Further it will be limited to General

Motors Corporation dealerships although it could be applied to others. The problems which will be covered include those requirements and regulations imposed by General Motors and those problems which particularly affect the small business entity.

General Motors has several requirements, regulations, and restrictions which make multiple dealership ownership difficult. Among the more important are the following. First, it is required that one man be held responsible for each dealership. General Motors wants to be able to know which person it can contact who can make the operation decisions for the dealership and who can be responsible for the dealerships actions. It will not allow a corporation to be a dealer; in other words, the "dealer" must be a "real" person. Next, the dealer owner must own at least 50 percent of the stock of the dealership. Further, it is required that any sales of stock exceeding the sale of the first 25 percent be approved by General Motors. Third, it is required that the owner acquire all of the stock within a specified period (generally five years) of the date of the obtaining the franchise. He can then sell the stock back to financial participants.

The problems of operating a successful small business can be overwhelming if not recognized and combatted. Those problems which relate to the type of business situation which the ownership of several small dealerships are dealt with. These include financial, strategy, planning, management, evaluation, and other problems. By attempting to solve these problems the small business can avoid its biggest stumbling block, cash insufficiency, and grow successfully.

Benefits of the solution which is reached are also discussed in an effort to verify the selection. By reaching this solution, it is hoped that a successful multiple dealership operation of this nature could actually be accomplished by tailoring the solution reached to the specific situation, an individual should be able to obtain adequate financial rewards which have heretofore been difficult to attain.

Use of the Holding Company Concept

Due to the constraints resulting from General Motors regulations, some ingenuity must be used in order to establish a multiple dealership operation. Before

becoming involved in any solution to the problems presented, an understanding of the General Motors franchise agreement terminology must be attained. The terms of particular significance are "dealer owner" and "dealer operator." When the major financial participant is not to be responsible for the daily operations of the dealership, the distinction between the terms becomes critical. The majority financial participant in this case is termed the "dealer owner" while the person responsible for daily operations (the general manager) is termed "dealer operator." A "dealer operator" is required to own at least 25 percent of the dealership's stock to signify his interest in successful operation. The "dealer owner" may also be a "dealer operator" as there may be more than one named. This can occur if the dealer feels that it is to his advantage to take this capacity. In general, it is beneficial to be a "dealer operator" in addition to "dealer owner" because of advantages in the naming of a successor dealer. Out of all the possibilities, a holding company effect could most probably be obtained by using a proprietorship as the holding company entity. The dealerships would be operated as separate corporations with the proprietorship owning the

shares of each corporation. The proprietor could then be named as the paragraph three "dealer owner" of the standard franchise agreement. The proprietor would be termed the "dealer owner" as a result of being the majority financial participant and should also be a "dealer operator" as a result of his management responsibilities. A minority stockholder would become a "dealer operator" and be responsible for daily dealership operations. His capacity would be general manager of the dealership. This would satisfy the General Motors requirement that there be one man who would be solely responsible for each dealership and allow the proprietor to have majority ownership in more than one dealership. In effect, this would constitute a holding company without being necessarily defined as one in the contract for the franchises. Since General Motors will not allow a corporation to be a dealer owner, this approach seems the only feasible way resulting from the fact that General Motors contention that in a corporation, they could not hold one person wholly responsible.

The proprietorship, through the proprietor ("dealer owner"), would be required to own at least 50 percent of the stock in each dealership corporation in

order to satisfy a General Motors requirement. It would be probable that he would be required to own 75 percent of the stock, at least originally. This requirement is based on General Motors interest in being able to hold one man responsible for the dealership. By owning 75 percent of the stock the proprietor would not have to be consulted in the disposal of the initial sale of 25 percent of the stock. Again, the General Motors requirement that any sale of stock which would diminish the dealer owner's interest in ownership to less than 75 percent must be approved by General Motors prior to that sale. If further sale of stock is desired, the approval that must be obtained can be attained only by proving that the person buying the stock must be of probable "significant benefit" to the dealership to warrant ownership. The "significant benefit" rule is not completely clear since it involves no precise requirements. It is only a subjective opinion initially made in the General Motors zone office and subject to review at higher levels in the hierarchy.

Benefits of the Corporate
Dealership Form

The benefits of the corporation can be attained by then using the corporate form for each of the dealerships. Even though the form for the holding company is a proprietorship, almost all business risks lies with the corporate dealerships, thus, there is no business risk involved for the proprietor except for the investment in the shares of the stock of the dealership as would be the case for owning the stock of any corporation. In this instance, however, the proprietor acting as the holding company has controlling stock ownership of the corporations and thus can to a greater extent control the value of the stock because of the managerial control than can be exercised over the dealerships.

There are several good reasons why the dealership should be formed as a corporation. These advantages would seem to be greater for this type of operation than those that would accrue to any other form. The first important benefit is that of limited liability for the shareholders. The shareholders of a corporation cannot be held personally liable for any debts or liabilities of the corporation in excess of their original

investment in the company's shares of stock. If the company were to fail, the only thing the stockholder would lose would be the money he put into the stock. The personal assets of the stockholder are not at risk. In a partnership or proprietorship form, the liabilities of the company in excess of the firm's assets can be satisfied from the nonexempt personal assets of the owners. Thus, failure of the business can mean personal economic disaster unless the business is a corporation, and the dealer is careful not to assume personal liability for actions of the corporation.

Another important consideration is that of the benefit of the tax structure of corporate rates. For successful businesses, the corporate rates can be of benefit to the reinvestment of income within the business. The corporate tax rates are 22 percent on income of \$50,000 or less and 48 percent on any income which exceeds \$50,000 (a 26 percent surtax).^{*} Since a person can only reinvest after-tax income, the maximum reinvestment can be attained by shielding the income of the business from the highly personal income tax rates that result for incomes in excess of \$100,000 annually (up to 70 percent marginal rate). If the taxpayer earns an income

^{*}Recent changes in tax laws provide for tax at 20 percent on the first \$25,000, and 22 percent on the next \$25,000 of taxable income.

which is sufficiently high to put him in a tax bracket which exceeds 48 percent, the corporate form would be beneficial. If the taxpayer is in either category his after-tax dollars available for reinvestment will be diminished more by the higher personal rates than by the corporate rates. Savings are available even for relatively modest incomes. The personal tax rate of 22 percent on a single taxpayer occurs at \$6,000 taxable income while he is taxed at a 48 percent on taxable income at \$32,000. For a married person filing jointly the appropriate incomes are \$8,000 and \$44,000.

The owner must be careful to avoid the Accumulated Earnings tax which applies to all unreasonable accumulations of earnings in a corporation (generally those in excess of a \$100,000 exemption). The tax is assessed unless there is a need for and a plan for using the accumulations for business improvement or expansion.

A further benefit of a closely-held corporation is the ability of the owner to also be an employee. Being an employee allows the owner several benefits. First, he can pay himself a salary and by doing this he can effectively avoid the "double tax" which occurs in the case of corporate dividends paid to shareholders in lieu of salaries. Dividends are not deductible to the

corporation and are thus paid from after-tax dollars by the corporation and are taxable to the shareholder. Reasonable salaries are deductible expenses to the corporation. Accordingly, only the individual is taxed when he receives the salary. The owner/employee must be careful here to avoid any conflict with the "reasonable salary" rule. The salary must be in line with salaries of persons with similar jobs and responsibilities. If salaries paid are more than reasonable the excess may be considered as dividends paid to the owner.

In concurrence with the benefit of the owner being a salaried employee is the maximum federal tax on earned income. This maximum tax occurs only on income which is earned from performing a service. The limit is a tax rate of 50 percent.¹ Thus, the owner/employee can pay himself a large salary from each corporation and be taxed at a maximum 50 percent marginal rate while the salaries are a deduction to the corporations. The taxpayer has no unearned income which would not be true if instead of a salary, dividends were paid to him by the

¹Ray Sommerfeld, Federal Taxes and Management Decisions (Homewood, Ill.: Richard D. Irwin, Inc., 1974), p. 64.

corporation. If the business is not a corporation, the taxpayer's income will not be a salary but will be a draw on the income of the entity and thus will probably contain a portion of unearned income. This is due to the fact that the taxable income of most businesses is jointly attributable to the presence of both service and capital. The IRS has arbitrarily decided that when this situation occurs, no more than 30 percent of the taxable income can be considered earned income, the remainder is considered "unearned." Thus, the maximum tax rate of 50 percent on "earned" income is available on 70 percent of it.² In addition, the maximum tax on earned income will allow the owner/employee to have the flexibility of re-investing the income at maximum tax rate of 48 percent (corporate tax rate) or withdrawing it immediately at a maximum tax of 50 percent.

Fringe benefits of these corporations could also be enjoyed by the proprietor of the holding company. These benefits are available to the employees of corporations to a greater extent than to other business entities. Since the proprietor is also an employee of the

²Ibid.

corporations, he will be eligible to take advantage of the benefits. The benefits range from those which are both immediately tax deductible to the firm and not taxable to the individual to those which are deductible to the firm but taxable to the employee. These fringe benefits can be molded into an attractive compensation package. All benefits are paid for by pretax dollars.

Group-term life insurance properly provided for employees is immediately deductible to the corporation and never taxable to the employee. Various limitations are imposed upon these policies. All premium payments on policies up to \$50,000 are qualified as tax deductible. Further, premiums for policies up to \$2,000 for employees' children are qualified. Another regulation concerns the number and type of employees covered. If the plan covers ten or more people, then certain groups of the firm can be covered. But if less than 10 fulltime employees are covered, there can be no discrimination between employees and owner/employees. Since automobile dealerships are the corporations being discussed, it is probable that any group covered would be less than ten. Thus, all employees should be covered. This would be true unless a group such as salesmen was large enough and was determined to be worthy.

Death benefits are also immediately deductible to the corporation and never taxable to the employee. These allow tax-free benefits to be paid to the employee's beneficiary up to \$5,000. Meals and lodging can also be benefits of this group. If provided on the firm's property for a corporate purpose, the costs are deductible to the corporation and can be excluded from the employee's income. Further fringe benefits include certain travel and entertainment expenses. Needless to say, when conditions are favorable, expenditures for personal pleasure can also be considered as business expenses, qualifying as tax deductible expenses. Expenditures for autos and airplanes, and other benefits such as interest-free loans and merchandise discounts may also be available as perquisites of the owners. As long as the employee pays for any personal use of the autos and planes, there is no compensation to him. The loans may be made available to shareholders and officers. There need be no interest charge, and as long as the transaction retains debt characteristics, there is no compensation involved. Discounts to employees are not generally taxable to the employee if reasonably small and if they are available to all employees.

Qualified pension plans, profit sharing plans, and stock bonus plans are in a group of benefits which are immediately deductible to the corporation and tax deferred (possibly to be taxed as long-term capital gains). H.R. 10-plans and I.R.A. plans are also in this category. The mechanics and limitations of the qualified pension plans are quite complex yet the tax benefits can be worthwhile. However, because of the complexities many firms choose to use nonqualified plans which can be tailored more to their specific needs. The nonqualified plans are deferred deductions to the corporation and deferred taxation to the employees. Qualified profit-sharing plans allow an employer to put a percentage of profits into a trust for employees which will be distributed after a period of time. In the stock option plan, stock is distributed to employees according to a plan which is nondiscriminatory.

The next group of compensation benefits which are deductible to the corporation but immediately taxable to the employees include salary and bonuses, nonqualified stock options, rentals, and interest. The nonqualified stock option plans are taxed to the employee at ordinary rates on the difference between fair market

value at the time of grant or exercise and the option price.

A final group of benefits can be classified as deferred both as a deduction to the corporation and as taxable income to the employee. The deferred taxation to the employee is beneficial only if the effective tax rate is considerably lower when the benefits are received than when the benefits were earned. This class of deferred benefits includes unfunded pension plans and deferred compensation arrangements. Unfunded pension plans' benefits are taxable to the employee when constructively or actually received and are deductible to the corporation at this same time. Ordinary rates apply to the amounts received. The deferred compensation plans essentially involve an employer's promise to make continued payments to a particular employee following his retirement. These would be additional payments for services the employee has already rendered. The deduction to the corporation and the taxation to the employee both occur when payment is made.

All other compensation is considered never deductible to the corporation and taxed immediately to the taxpayer. These include dividends, redemption of stock

as a dividend, gain on the redemption of debt, constructive distributions, and qualified stock option plans. They offer no particular advantage to either the employee or the corporation.

The corporation can take advantage of a type of no cost "insurance" for the corporation itself. This involves Section 1244 of the Internal Revenue Code. Available to corporations selecting this option, this section can be of significant value to shareholders who sustain losses. Ordinarily when stock becomes worthless the result is a pure capital loss and is subject to the limitations of all net capital losses. Stock qualified under Section 1244 allows the original purchaser of the shares who experiences the loss to deduct up to \$50,000 of the loss as an ordinary loss in a single year. If an individual is in a high tax bracket, Section 1244 can make risky investments easier to bear because the IRS is willing to permit the write-off against ordinary income, thus resulting in tax savings. Yet, the gains which may accrue will be taxed at the more advantageous capital gains rates. Even if the shareholders might not expect to sustain losses, Section 1244 should be taken advantage of because the benefits outweigh any

complexities of qualification of the stock. The requirements are as follows: (1) the shares must be common stock; (2) the corporation must adopt a plan to issue such stock, and the stock must be issued within two years after the date the plan was adopted; (3) the corporation must be domestic and meet two small business requirements; (4) the money plus the net tax basis of any other property received for the stock must be less than or equal to \$500,000; (5) total equity capital cannot exceed \$1,000,000; (6) at the time the plan was adopted, no other offering of stock can be outstanding. There are also the following loss requirements: (1) the taxpayer sustaining the loss must be an individual; (2) only an individual to whom the Section 1244 was originally issued may claim the loss; (3) the loss must be sustained by an operation company. The loss treatment is available when the stock is sold or deemed worthless. These qualifications would present no complications to an existing automobile dealership since new stock can be issued in place of the old. This new stock can easily meet the qualification. If a new dealership is to be established, the original stock can be issued as Section 1244 stock.

Another reason for establishing the dealerships as corporations is that all organization expenses can be amortized over a five year period. For other business entities, these expenses are treated as nondeductible capital expenses. Furthermore getting started expenses are deductible to the corporations as are any preoperating expenses. These should be carefully documented and taken advantage of by the dealerships. Preoperating expenses such as investigation expenses might also be deducted by the holding company. Deductions are available if the expenses are for the broadening of the business.

The holding company proprietor should be worried about the transferability of the stock he owns in the various dealerships whether it be at death, as a gift, or as a sale. Since the proprietor holds shares of stock, whenever he sells the stock he will realize long-term capital gains on its sales. At his death any shares will be passed to his heirs at a stepped-up basis effectively allowing a large part of any capital gain to go untaxed. This is due to the fact that the stock will have as its basis the fair market value at date of death or six months later. The gift tax rules are more complex, but given that there has been an appreciation in

the value of the stock, the donor's basis is used as the new basis. No matter the method of stock disposal, the stock is easily transferable and can be valued in a reasonably easy process. The latter advantage can be very useful since the value of many other types of assets is questionable and will vary according to assessor.

Financial Considerations

The financial arrangements which are made must be both viable financially and acceptable to General Motors. Since the proprietor is going to be the "paragraph 3" dealer as was discussed earlier he will have to put up the major share of the capital investment. In addition, if he intends to own all of the stock and thus have no minority partners, then he must put up all of the capital involved. There still remain restrictions imposed by General Motors.

General Motors has several requirements for the financial structure of a dealership, either newly established or purchased. In addition to whatever amount (if any) of the funds he may have to invest in real estate and facilities for the dealership, a dealer-

operator is normally required to invest at least 25 percent of the proposed and approved owners' equity on an unencumbered basis. This qualification is for working capital only. While this is not a completely arbitrary standard, General Motors desires that the person who is the dealer-operator and who is entrusted with the responsibility for operating a business which could generate millions of dollars in sales annually should have demonstrated his ability to manage his own personal finances by accumulating enough capital to permit a substantial initial investment. By providing this type of personal investment from accumulated savings, the dealer operator reassures General Motors that will make a sincere effort to operate the business successfully. The balance of the initially required capital investment can be provided by an approved financial participant. Under circumstances where an existing dealer desires to sell out to an approved applicant, a Buy-Sell agreement can be arranged. Such agreement allows the new dealer to buy the dealership over a period of years on an established contractual basis with either a predetermined price or a formula to determine the price of each block of stock purchased. It is possible to finance a buy

out with long-term notes. The dealer-operator who wishes to establish a dealership in an open area must either supply all of the initial capital outlay or buy out his financial participants within a specified period of years, normally five years but extendable if necessary to several more years. After a dealer accomplishes his buy-out, he may then allow reinvestment by outside participants which can include those whom he has previously bought out. But General Motors does extend a restriction on this type of reinvestment. General Motors must approve of any participant if the dealer wishes to sell more than 25 percent of his investment. Thus, the dealer may dispose of an initial 25 percent of the stock without restriction. But any transaction after this point is passed must meet General Motors approval. In this manner, General Motors can exercise a degree of control of the independently operated dealership. Approval is made on the basis of the participant being capable of providing a significant benefit to the dealership.

Another requirement concerns the nature of the initial financial participant. Bank loans are not to be considered as this type of participant. This is a restriction which General Motors has because they do

not want any possibility of a bank controlling the dealership or have a bank in the position to own a share of the business due to default on a loan. They feel that just by being a participant in a lending sense that the bank can and will extend a degree of control on the dealership. This restriction can be a hardship on the person wishing to acquire a dealership. When it is difficult to find an approved financial participant, General Motors through the Motors Holding Company may come to the prospective dealer's assistance.

The Motors Holding Company is a division of General Motors. Its objective is to assist in the development of quality General Motors dealers, adequately and independently financed and operated. Financial assistance is extended to those individuals whom General Motors feels have desirable personal qualifications but through circumstances neither possesses nor has access to adequate capital of the right kind to finance a dealership properly. Motors Holding provides a source of capital for these individuals with which they can set up and operate dealerships until the dealerships become financially sound and can pay for themselves. The three

categories of situations which Motors Holding is designed to help are the following: (1) to supplement an individual's capital resources so as to enable him to establish a new dealership, either succeeding an existing dealership or at an open point; (2) to enable an individual to buy out inactive partners so as to more efficiently utilize profits in assuring the long term success of the business; (3) to provide equity capital as a supplement to the franchise investment for the acquisition or construction of modern and efficient facilities and operating capital required to serve an expanding market. When in the process of expanding, Motors Holding should definitely be looked into if access to necessary capital is a problem for the dealer.

Individuals wishing to be able to obtain aid from Motors Holding must meet several requirements. The basic requirements include the following: (1) recommendation by the car division having jurisdiction; (2) demonstration of ability to successfully operate a dealership; (3) satisfactory sales and profit potential of the franchise; (4) ability to make a satisfactory investment, usually not less than 25 percent of the required capital; (5) subscription to the business policies recommended by Motors Holding.

When an investment is agreed upon, the dealer-operator is named president and a director of the newly formed corporation. Motors Holding retains voting stock control during the period in which it is an investor-stockholder. By using Motors Holding assistance, a dealer has to give up control of the firm until the loan is paid in full. For this reason it is highly desirable to avoid this kind of situation. But if this is the only way possible to expand and a highly desirable dealership opportunity presents itself, this can at least make an acquisition possible at reasonable financial cost. By all means though, in the type of organization about which this paper is concerned, expansion should generally only be considered when enough capital is available from within the organization. Full control of the new corporations is retained by the organization. Such a policy will also prevent financial and managerial problems which result from spreading the available resources too thinly to allow effective operation. If recourse is made to Motors Holding, profits must be shared. While the dealer receives a salary, a cash bonus provision, and a share of the earnings, he does not have full control of the profits distribution due to the arbitrary arrangement insisted upon by Motors Holding.

It should be emphasized that all of the discussion that has taken place on capital concerns working capital only. The capital to be used for the real estate portion of the investment should be arranged separately. Even though working capital and fixed capital are arranged for separately, both should be financed as much as possible through retained earnings and the personal finances of the owner with the exception of possible financial institution loan arrangements on the real estate finances. In this manner, effective control can be maintained and as a result, the owner can operate each of the businesses at his own discretion. When there are additional financial participants, control is shared. Therefore, in the type of expansion which the holding company undertakes it is advisable to expand only when the finances are available at terms most favorable to the owner. Bank loans may enter the financial structure for real estate, and for additional working capital after the start of operations.

The amount of debt which is to be used in the dealerships can be determined by the holding company. The proprietor must look at the overall financial picture of the firm by taking all of the dealerships and

looking at them both individually and grouped together. In this manner, a decision can be made on what is best for each corporation as well as what shape the holding company is in. The ability of the firm to finance any expansions or to add finances to individual dealerships is determined by the overall picture. It is necessary to review financial structure in this way because by funneling more finances into one of these areas may severely damage or impede the operations of the other dealerships.

One method of determining the proper debt-equity ratio for small businesses has been advanced by Dr. Ernest Walker, Professor of Finance, The University of Texas at Austin.³ The method entails determining the certainty of the firm's earnings. Larger firms use the theory which entails the cost of capital as the main criterion of the amount of debt the firm should use. The Walker method considers the probabilities of earnings before interest and taxes. The amount of earnings before interest and taxes which earns the same amount on equity capital no matter what the debt-equity ratio must be calculated. Then the owner must determine the probability

³Ernest Walker, The Dynamic Small Firm (Austin, Texas: Austin Press, 1974), pp. 203-204.

of the firm earning this amount. If he is certain that this amount can be attained then it is safe for the firm to use a great deal of debt. If he is not so sure of making that level of earnings, then he should only consider smaller amounts of debt. In this way, he can decide what risk he desires to undertake by taking on debt which entails making the fixed payments which accompany. The formula for determining this point is the following

$$\frac{X-B}{S_1} = \frac{X}{S_2}$$

where X = the indifference point, S_1 = number of common shares or amount of equity capital when only equity is used, S_2 = number of common shares or amount of equity capital when only equity is used, and B = bond interest in dollars.⁴ By using the amount of equity capital rather than the number of common shares, one can figure the results for an organization which is not incorporated as the holding company would not be. One would then be using as part of the determining factors earnings to equity rather than earnings per share.

⁴Ibid.

In making the debt/equity decision, he must take under consideration the difficulty of obtaining equity capital and the fact that each dollar of debt to the small firm does not have as much leverage affect on equity as it does in a larger firm. This is a fact because the small firm is burdened with a slightly higher cost of debt capital coupled with a slightly lower return to capital. In taking these factors under consideration, Walker suggests that the small firm accept projects that are free from the risk of insolvency. In this manner, a larger amount of debt can be undertaken. This situation results from the firm being better able to determine earnings. The fact which stands out here is that more small firms go under because of lack of cash to meet fixed payments than from any other cause.⁵ It is important to the holding company to decide the rate at which to expand and the manner of operating the existing dealerships in light of these known risks.

There can be several different arrangements for financing the real estate and other fixed assets

⁵Donald Dible, Up Your Own Organization (Santa Clara, Calif.: Entrepreneur Press, 1974), p. 177.

of the dealerships. Each dealership corporation could decide to own and thus be forced to finance their real estate and other fixed assets. The burden would be on each individual dealership to be able to obtain the finances. Thus only their individual borrowing power could be used if retained earnings were not available from within the firm. It would be possible for them to be backed up by the proprietor's name and reputation. But for the dealership which is just being originated there are no retained earnings; so all funds would have to be borrowed or come from equity capital.

Another possible method for financing in this vein would be for the individual dealerships to be able to borrow from the other existing dealership which the holding company owns. Since the proprietor controls all dealerships, a pool could be set up for borrowing and lending in this manner. Then all financing could be kept within the organization. This would allow for expansion of dealerships and their markets in a more controlled type of environment than would otherwise be possible. This control would reduce differences in interest rates and bank lending policies by allowing fixed rates and standard policies set by the organization itself.

By using internal financing, a plan for expansion and capital expenditures can be set up using fewer variables than would be normally true. It is possible that the interest earned by the dealerships on the money that they lend to their fellow dealership would fall short of the rate which they could earn by investing it themselves. But since the proprietor owns the stock of each, he can tell what would be best for the holding company overall. The profit potential of the expansion can be great enough to overcome the shortcoming of the lost opportunity cost of the individual dealership. This type of arrangement also has the advantage of avoiding the "double taxation" which could occur if the proprietor took the money out of the corporation as dividends and then lent it to the new dealership. By avoiding removing the funds from the corporations, the funds are only taxed on the corporate level.

The best method of financing the real estate and fixed assets could go a step further. The holding company will earn fees from the dealerships by providing services (to be discussed later) to them. These fees are tax deductible to the dealership as an expense of doing business. These funds in addition to the

proprietor's own funds to be supplied as he desires or as is necessary can be used to buy the real estate and fixed assets in the name of the holding company. The holding company can then lease the assets to the dealerships on a business basis. The lease payments made by the dealerships would be tax deductible to them. The assets can then be depreciated by the holding company. Since the assets and expenses of a proprietorship are considered by the Internal Revenue Service to be owned by the proprietor himself, all taxes and deductions will be based on his tax rate. Given that his tax rate is higher than the 48 percent corporate rate, he will benefit because the depreciation deductions will be worth more to him. He should also be able to take advantage of the large investment tax credits (currently up to 10 percent) available. Since the amount spent on depreciable assets and those on which the investment credit can be used (probably everything to be purchased with the exception of land) will be quite large, the proprietor's taxes can be reduced significantly in this manner. By not being subject to being reduced in effectiveness by the "double taxation" effect, they are even more beneficial. If the assets were bought by the dealerships,

the benefits would be used at a lower tax rate first and then only part of the benefits would be passed on because they would then be taxed as dividends when the proprietor draws his return from the corporation.

A further benefit to this latter method of financing the real estate and fixed assets stems from the fact that the proprietor can retain more control of each dealership by owning the assets. Since the dealership is a franchise operation granted by General Motors, it follows that they can extend control over operations to a certain degree over it. By putting as much of the investment as possible in his own hands, the proprietor can retain more control over the dealership. Further the disposal of these assets is at his discretion. If he decides to use the real estate (for example) for a more lucrative purpose, he is free to do so. He owns for all practical purposes both ends of the lease agreements, so they can be cancelled at his will. Sale of the assets can result in capital gains to him. In addition, if he desires he can pass these assets on to his heirs on a stepped-up basis. If the corporation were to own the assets, they would have to be sold to the proprietor at what would be considered a reasonable price by the IRS

if he desired to pass them on. Or he could pass the stock on at a stepped-up basis. Nevertheless, he would possibly lose a degree of control by not owning the physical assets of the business.

It should be mentioned here that General Motors will provide financial aid for land and facilities through its Motors Holding Division. It will provide these funds to supplement their regular or franchise investment plan. Under this plan, one-half of the total facilities cost must be obtained through a conventional mortgage loan. The loan must be amortized over a term of at least ten years with equal payments and bear interest at a maximum of 6 percent annually. Through stock arrangements, the plan provides for the rest of the necessary capital after an initial investment by the dealer.

Organization

The holding company would have many responsibilities for the proper management of the firm in addition to those previously mentioned. The individual dealerships will be strictly concerned about the day-to-day operations of the firm. This would concern new and used

auto sales, parts sales, service sales, body shop sales, new car preparation, used car reconditioning, and other services necessary to daily operations. In addition, there are many purchasing decisions to make, such as the numbers and types of new cars, used cars to balance inventory, and the daily restocking in the parts department. Management of each department will also take place to a large extent at that level. It is important for this to occur because decisions must be able to be made immediately without the delay which would naturally occur by having to wait for the decision to come from the holding company level. Operating decisions would be concerned with what prices to sell each car, trade-in values, service complaints and problems, and other daily occurrences common to operations. For unusual problems, the holding company proprietor would be consulted. This in itself says something about the nature of the proprietor's responsibilities -he must be available and in contact with the dealerships on a daily basis most of the time. He cannot spread himself too thinly or he cannot effectively control the dealerships.

Each of the dealerships must have one person within it which is responsible for the entire operation.

In General Motors' terms, he is defined as the dealer-operator. He is the one person which General Motors and the holding company can hold as fully responsible for the dealership's operation. This individual should be named general manager of the operating corporation. Directly below him in authority are the managers of the various departments of the dealerships. The organization below them can be set up as the managers decide, but a high consistency between dealerships to facilitate overall control and evaluation by the holding company should be maintained. The dealerships can be operated as independent enterprises. Any innovation by one dealership though can and should be transferred to the other dealerships as quickly as possible. This type of discovery which can be made on the dealership level include changes in the market, service problems, or more efficient operating procedures.

The overall organization of the firm will be kept as simple as possible. The proprietor will be the chairman of a board of directors. Through his chairmanship, he can control the holding company and his dealerships. Even though he would hold control over the dealerships through his stock ownership, he will be more able

to effectively coordinate the overall activities from this position. This type of organization can make this coordination much easier. Rather than operating several parts separately, the holding company and its board can work together in a manner beneficial to all. The members of the board of directors should be the general managers of each dealership corporation. In this manner, the point of view of each dealership can be represented on the board. This also facilitates maintaining effective control over the way the dealerships are being run. In addition to these internal members, directors not involved in the firm should be placed on the board. An outside director of this nature brings a more objective point of view to the firm than the internal members will bring. The internal members, no matter how they try not to, will generally be prone to subjective, somewhat biased viewpoints concerning the organization. Outside board members can include any of the following: a lawyer, an accountant, a business professor, a successful businessman (active or retired), or any other individual who can provide beneficial advice in an objective manner for the firm.

The result of organizing the firm in this manner is a geographically organized company with each corporate dealership being relatively self-sufficient. The holding company will provide central management and services since these can be more effectively and efficiently performed by the holding company. By concentrating management and central services in the holding company, more highly qualified personnel can be hired at a lower cost since fewer will be needed than if each dealership performed the functions. Only those services which need not be performed at each dealership can be performed centrally. Also, by having the holding company perform them, the proprietor can keep closer to each situation and more aware of the important overall situation including all of the dealerships.

Strategy

The first major responsibility of the holding company through its proprietor and board is to provide the strategy for the firm. The strategy will be determined by the goals of the firm (basically those of the proprietor), the environment in which it operates, and

the resources with which there are to work. Strategy must be mapped out if the business is to succeed. Many small businesses fail because they have neglected to do this.⁶ The first step in determining strategy is defining the objectives which the company will try to attain or what progress it should make. Objectives can be set for profitability levels, market shares, acquisitions, sales revenue, cost reduction, sales volume, return on investment, asset turnover ratios, and so forth. The automobile dealership must consider each of these carefully and determine the combination best for the firm and the owner. The marginal concept of economics should be applied to this type of decision.

The second step of strategy-making would be a close look at the resources at hand. The resources are the means under the company's control that can be used to reach its objectives. The resources of an automobile dealership of this nature include the proprietor's personal funds, the retained earnings of the holding company and the dealerships, the borrowing power of the holding

⁶Steven C. Wheelwright, "Strategic Planning in the Small Business," in The Dynamic Small Firm, ed. Ernest Walker (Austin, Texas: Austin Press, 1974), pp. 111-112.

company and the dealerships (backed by the proprietor's reputation and borrowing power), and the aid which General Motors can provide through Motors Holding. In addition to financial resources, other resources include manpower, plant, equipment, and any distinctive competence. To the dealerships, distinctive competences such as especially good service departments or a flair for advertising and promotion should be an advantage and used in the strategy. The combination of resources will dictate how effectively the objectives can be accomplished. The company will not desire to spread its resources too thinly which could move it toward cash insufficiency, the perennial small business threat, especially in a market which can be affected by an oil crisis.⁷ When an oil shortage forces consumer demand of autos down drastically, the automobile dealerships must have sufficient resources available to weather the crisis. The drastically reduced demand during parts of 1974 and 1975 resulted in a high rate of dealership failure. The holding company must be sure that they can successfully overcome a malady of this nature. This discussion has included a

⁷Dible, Organization, p. 177.

portion of the third element of strategy, the environment. The holding company must look into the future towards those circumstances over which the firm has no control. In addition to the external environment such as the economy, the oil supply, political events, inflation, competitive conditions, and public opinion, there is an internal environment to consider. This generally includes employee problems, the ability to retain good employees, collection problems, and internal strife. The holding company should strive to alleviate as many environmental effects as possible.

Strategy formulation determines how the holding company will combine the above-mentioned factors. Several alternative strategies should be considered, and the most-likely to succeed should be used. The time span of the strategy must be considered and will be a determining factor in deciding what strategy to employ. The strategy itself will define policies or rules to be followed in the effected time span in order to attain implementation. These policies and rules should allow enough flexibility to meet any contingencies as they arise. The contingencies which can arise in this firm are auto shortages due to factory strikes, rising

prices, and other environmental factors. It is important that the strategy be set by all of the board of directors because they are the persons responsible for carrying it out.

Planning

The holding company will also be responsible for planning the operations of the dealerships after the strategy has been determined. The planning aspect determines how the strategy will be implemented. Planning includes factors such as personnel deployment, capital expenditures, internal control procedures, budgeting, quota setting, marketing efforts, pricing policies, and sales campaigns. Planning must consider objectives, forecasting, and analysis over the planning time frame. In many small businesses, there are barriers against effective planning. Small companies' management is often too preoccupied with the dousing of day-to-day "brush fires." But the usual tightness of money in small companies makes planning essential. It is particularly important in this case to properly allocate the firm's resources. Furthermore, it is important for the manager to realize that

it is the long-term future which will result in significant financial rewards. He must plan with this in mind. The long-term should not be sacrificed for the short-term.

Planning means tackling problems over which there is great uncertainty. But by planning, these uncertainties can be recognized, reduced, and prepared for. Planning properly will eliminate many of the day-to-day "brush fires" that usually occur. The company can take advantage of outside advice, internal sources, and external sources in the planning process. The outside advice can come from the board of directors of the holding company who are not internal directors. This is one reason why it is advantageous to have a lawyer, an accountant, and possibly a banker on the board. Internal information can come from the company cost accounting system (which will be compiled by the holding company) and from various internal control reports from the dealerships' departments. It may not be necessary to revise the existing information systems. The firm may be able to take advantage of the existing systems. The structure of the reports should clearly show the important aspects of each department and include an analysis of

the contribution to profits. Further the volume of information should be reduced to only the factors which the management considers important. External sources from which information can be gleaned include the employees of the company, customer surveys, the related automobile divisions, written materials, reference books, university professors, and libraries.

Overall Management

The holding company will be responsible for the overall management of the dealerships. This type of management includes all general management except that of daily affairs. The type of management to be used should allow each corporation to operate relatively independently. Daily operations will be controlled by the general manager of each. The proprietor should be available to solve the problems which arise and cannot be handled by the dealership personnel. He should (with the aid of the board of directors) also make all decisions involving capital outlays, financial arrangements, major marketing, sales, and pricing decisions, and all major inventory policy decisions. These decisions will be

passed on by the proprietor through his position as president of each corporation and chairman of the board of the holding company. Decisions of this nature include the automobile inventory purchases. This type of decision can influence all of the dealerships and should be made through a meeting of the general managers of the dealerships. The proprietor can determine the decision process on a continuing basis.

Evaluation

The evaluation process can be made in much the same manner. Evaluation is a critical part of the management process. The results of the evaluations provide direct input to the strategy and planning process. The main sources of evaluation will be the cost accounting data and internal control reports, the general managers' observations, the proprietor's observations, and comparisons to other dealership situations. The cost accounting data and internal control reports can supply insight on those areas of operations which are efficient and profitable and those which are not. With this data, trouble spots can be identified and further investigated. The

general managers' observations are a good source of evaluation material due to their close relationship to their situations. They are in the position of being responsible for their dealerships and thus should be in a good position to gather appropriate facts and ideas on the dealership level. The proprietor must then be able to assimilate the evaluation information gathered. He must weigh the information and make final decisions, by himself on the dealership level and with the board on the holding company level. Comparison data is available from other dealerships from the related auto division. This data is furnished monthly and provides a good basis for determining performance in relation to dealers in comparable situations. These figures can give the dealer an idea of where he needs or can make the most improvement. The figures are furnished on a departmental basis.

Central Services and Functions

The holding company will also be responsible for accounting, innovation and research, marketing, inventory control, and, as mentioned earlier, financing functions. The accounting can be centralized easily,

and the centralization can be an advantage to the holding company as well as the dealerships. The accounting (which includes the bookkeeping function) can be done in the central office by gathering the proper figures from the dealerships at the end of each day. By performing the accounting function in this manner, more effective control can be exerted because performance can be measured both overall and by dealership as often as is deemed necessary by the proprietor. The function can be facilitated through the use of a small-business computer. The properly chosen computer can perform all accounting functions plus prepare many types of internal control reports at any point in time. This allows the proprietor a more extensive and continuous control function. The profitability, sales, costs, ratios, and other performance factors can be measured in this manner. A set of books should be maintained for each dealership and the holding company separately while a set should also be compiled for the overall operation.

Innovation and Research

Innovation and research can also be best performed on the holding company level. This prevents the

maintenance of these functions at each dealership. While this function is not to be banned from the dealerships, it is often a difficult and time consuming job which is ignored anyway at that level. At this time, the industry is making rapid advancement in both the knowledge field and in mechanization. On the dealership level, this task then is becoming harder and harder to perform. This is why the holding company should perform the function. It is possible that the function could be performed, at least in part, by the proprietor himself.

Marketing

The marketing function can also be best coordinated and instituted by the holding company. The marketing function--pricing, promotion, product, and distribution--needs to have a central controlling force which would allow a more extensive and cohesive marketing plan than could be accomplished by making each dealership try to perform the function. More effective marketing research can be undertaken by the holding company because it can take more time and has a broader market perspective than the individual dealership does. It can look

at larger surveys, search more data, and spend more time in determining the marketing mix which fits the dealerships best. Pricing policies can be best selected by the holding company through surveys and examination of a large segment of competition. Promotion can be arranged on a larger and more coordinated scale than possible on the dealership level. Newspaper, billboard, and radio packages specially designed for the dealerships combined effort can be prepared and executed. The dealerships individually could not afford promotion schemes on the scale that would be possible on the holding company level. Product lines must also be determined. While the auto line can be changed in a major move, other decisions must also be made. These include whether or not to carry related lines of your General Motors division such as the Chevrolet LUV truck line, the Buick Opel line, or the larger Chevrolet diesel trucks. Another decision would concern whether or not to engage in a leasing operation in a major way. Each line costs money to obtain and maintain. In addition, a parts stock must be maintained, and service personnel must be educated. Through its better marketing ability, the holding company can choose the products more intelligently. Distribution decisions by

the holding company would mainly include determining when and whether or not to move some of the automobile stock around between dealerships. Furthermore, the amount and types of cars to order for stock is an important consideration. By being able to observe the overall situation, the holding company can see where there are too many cars, where certain lines are over-or understocked, where sales potential indicates moving cars to another area, and the sales trends of the various car lines.

Inventory Control

The distribution function of marketing overlaps into the inventory control function of the holding company. Beyond the auto inventory control, there is also the aspect of parts control. By being forced to stock parts at all of the dealerships due to the service department requirements at each, a system of sharing inventories should be advantageous. By sharing, a part that is relatively slow moving could be stocked by only one dealership (while making certain that not just one particular dealership be burdened by carrying an excess of this type of part) allowing the part to at least be stocked. By having several dealerships, the

likelihood for the part being demanded would be significantly increased. The holding company could best maintain an inventory system of this nature. Also by using the proper computer, inventory analysis could take place allowing proper inventory size, economic order quantities, and order timing to take place. This type of service could possibly be purchased by each dealership individually, but the price could conceivably be lowered and a larger degree of control exerted if the holding company performed this inventory service. Effective control is the key here.

Financing

The financing functions performed by the holding company have been discussed to a fairly thorough degree earlier. An advantage to using the holding company concept in addition to those advantages mentioned earlier, is the way in which the increased borrowing power could aid the dealerships in obtaining an advantage in floor-planning financing. By using the greater credit ability of the combined dealerships, the floor-planning could be done at a slightly reduced rate. Also, by

having the holding company in charge, resources can be channeled to the areas in most need. The holding company through its overall perspective can best measure the needs for the combined good of the dealerships (and which as a result benefit the proprietor most) which would be extremely difficult if there were no holding company but only the stockholder. The organization and perspective of the holding company would be a benefit over that arrangement.

Captive Finance Company

Another benefit of the holding company entity would be the ability to form a captive finance company. By using a captive finance company, a firm such as the automobile dealership holding company which sells a product almost exclusively on a financed basis can participate in the profits from the interest payments. The finance company would be established as a wholly-owned subsidiary of the holding company as a finance company for the time-sales paper generated by the dealerships. The subsidiary would be given cash capital of its own and would make arrangements with outside financial institutions to obtain leverage borrowing. The cash

capital given to the subsidiary would be the determinate for the maximum rediscount line.

The maximum rediscount line normally starts on a conservative basis such as a 1-1/2 to 1 ratio of cash loanable to the finance company for each dollar of cash capital that it puts up. After confidence can be established between the two parties, the line can periodically increase up to 3 to 1 or possibly 4 to 1. For example if the cash capital was set at \$100,000, the subsidiary could obtain \$400,000 from the outside institution. This type of leverage is a prime attraction for establishing this rediscount arrangement.

The establishment of the subsidiary is usually made to facilitate growth of sales on an installment basis, an objective being to enhance profits from increases in volume. A standard financing package for all of the dealerships should be established which can allow salesmen to do a better, more consistent selling job. Also, by carrying its own paper, the holding company can maintain closer contact with customers which should result in continuing sales on a repeat basis. Lastly and most importantly, the company can also make a profit from the financing itself.

To determine the profit-making potential of the subsidiary, the cost of the rediscount must be compared to the cost of discounting paper with an outside source. In this manner, the true profit can be determined. The financing profit is generated by the excess of add-on income on the sales over the cost of money and handling. The three variables then that are the important factors are the following: time-sales price differential, handling cost, and rediscount interest cost. The netting-out of these factors determines the profit. The time sales price differential will generally run at about 10 percent per year yielding an income of approximately 20 percent interest on its money. The physical handling of the paper should average between 1 percent and 3 percent of the contract sales price. The handling price includes preparing payment books, entering payments, checking credit, and making collection follow-up. The cost of rediscounting funds varies between 6 percent and 12 percent simple interest which depends on the source and the application of the funds.⁸

⁸Royce Diener, How to Finance a Growing Business (New York: Frederick Fell Publishers, 1974), pp. 220-221.

A further cost factor is involved--bad-debt loss. This loss is usually not as significant in a captive finance company as it is in an ordinary operating business.⁹ In the captive company, there should be more prudent credit policies, and the receivables are covered by a contract of conditional sale rather than being on an open account basis. The possibility of repossession can force the customer to make strong efforts to avoid losing any equities he has invested. A conservative estimate of the cost is approximately 1-1/2 percent. These losses can be set higher for income tax deductions.¹⁰ The deduction further cushions the effect of the loss.

Personnel

To be able to provide these services to the dealerships, the holding company will need to hire personnel. The number of dealerships under the holding company's management will determine the actual number of employees, but the basic types of jobs will remain

⁹Ibid., pp. 221-222.

¹⁰Ibid.

the same. There must be a bookkeeper capable of maintaining the records. In addition, this employee should be able to run the type of computer used since most of the bookkeeping will be processed through it. A secretary to handle the clerical work must also be employed. This position will grow in the numbers necessary to fill it as a direct function of the number of dealerships acquired. Thirdly, since the proprietor will be responsible for general management, he will need an administrative assistant to aid in performing his tasks as the dealerships and related business responsibilities increase in number. This employee will be in a key position as the company grows since the proprietor will have to limit his attention to strictly the major decisions because they will be more numerous than they were before an acquisition. The assistant must be able to carry out the proprietor's decisions and provide administrative assistance. The proprietor must not overburden himself and as a result stretch himself too thinly which would eventually reduce his effectiveness. This type of assistant should be a college graduate with a degree in business administration. This position could be used by him as a stepping stone to becoming a general manager

of one of the dealerships or to acquiring a dealership of his own at a different location. This work experience could be valuable to both the assistant and the company.

Computer Use

Since mention has been made of computer usage, it is appropriate to discuss it further here. Computer services are available from various companies in metropolitan areas. The fees for the services range in price as do the extent of services offered. The question is raised of whether or not the firm should have an in-house computer. The financial feasibility for owning or leasing an in-house computer must be based on present value decision procedures. Side benefits such as increased specialization through custom-programs, ability to perform services not available from other companies, and control over the price and consistency of the services are also to be weighed in the selection process.

Presently, there are computers which are specially designed for dealerships which are becoming available on the market. One such computer which would seem to be suitable for the holding company operation is the

"Easi-II" made by Investment Control, Inc. The benefits of the unit are many and several of the benefits are not available from computer service companies. Since the holding company would be operating on a large enough scale, the benefits of this type of specialized knowledge could be obtained. This particular computer has been especially designed for General Motors dealerships and has been highly mentioned by the Chevrolet division. The computer system was developed by combining the knowledge of experienced automotive people and qualified computer technicians. The system ties together all of the departments of the dealership. This type of system will take care of all of the services which can be purchased from computer service companies plus some others. It provides sales follow-up ability even on used cars, new and used car inventory control, and warranty processing and collecting. Of these, the warranty processing and collecting is most unusual. By supplying this service, the system goes far in making itself a valuable tool. The cost of different systems varies. The "Easi-II" sells for \$67,000 outright or leases for \$1,450 per month. A decision of this nature, of course, must be made on a present value basis including the lease or

buy proposal. A further benefit is the ability of the dealer to keep all data on a private and a "need-to-know" basis.

Acquisitions and Expansion The Existing Dealership

When choosing the possibilities for expansion of the holding company, decisions must be made for choosing among existing dealerships, applying for new dealerships, and integrating the new dealerships into the system. By deciding to acquire an existing dealership, the company can benefit from several aspects since the dealership is presently operating in the market place. First, the dealership has been operating in a defined market area. Examining this situation allows the acquirer to see what has been done in the past and postulate the potential existing for the future. In this manner, the value of the dealership can be more easily and accurately determined since there is an historical basis. Second, the dealership has existing facilities. This can reduce time and cost of initiating operations for the holding company due to a reduction of building and preparation time. The existing dealership can also be undervalued

for various reasons. Factors involved in forcing a situation of this nature include mismanagement of the dealership's resources, environmental problems (internal or external), or the retirement or death of the dealers. The dealership may have a value below what it should actually be worth on the market place with the proper management. It is possible that an excellent deal can be arranged with a dealership in this type of predicament. Finally, part of the dealership personnel may be qualified to be a part of the new dealership. This can save both recruitment efforts and costs. In starting a new dealership from scratch, outside recruiting would be necessary although some holding company personnel may be able to be switched to the dealership. In purchasing an existing dealership, an evaluation of the purchase price must be made. One of the best methods for pricing is using an earnings-multiplier. Using this method, a total price is determined by multiplying a certain number of years times the present level of profits. But unless the evaluation is taken one step further, a complication arises. What one dealer can earn on the assets may differ from what another can earn on those same assets. The discrepancy must be taken into account. This

is done by using the seller's present earnings multiplier in an effort to determine what the business is worth to the seller as he operates it now. Then the buyer's multiplier can be applied to those same assets determining what the purchase should be worth to him. The probable purchase price will be somewhere in the middle ground between the two values. In making this determination it is often advisable to remove any non-operating assets whose value may distort the earnings figures. Further, in determining the final decision of whether to buy or not, it may be advisable to determine the probability of the firm remaining solvent in conjunction with using present value techniques. A small business such as the holding company in question cannot survive a "cash crunch" as easily as the large company can.¹¹ Since this is true, then risk of insolvency should be examined and judged with respect to the proprietor's utility function.

Tax implications should also be considered before any acquisition is attempted. The buyer should pay

¹¹Sheridan C. Biggs, Jr., "Survival of the Smallest or How a Small Company Can Reach the Other End of the 1970's," in The Dynamic Small Firm, ed. Ernest Walker (Austin, Texas: Austin Press, 1974), p. 6.

special attention to allocation of value to the assets involved in the transaction. His point of view may be in conflict with the seller's in this aspect. The seller will wish to value any inventory at the lowest possible price and allocate a higher proportion to non-depreciable items such as goodwill and land. This arises because the sale of inventory produces ordinary income for the seller while the sale of the nondepreciable assets (and certain depreciable ones) will allow recognition of capital gains. The holding company should try to put as much of the allocation as possible into the depreciable assets. The holding company is not intending to sell the dealerships in its near future; therefore, it should concentrate on receiving future depreciation on buildings and equipment which qualify as tax deductible expenses¹² rather than on receiving future capital gains. Since land cannot be depreciated, then an effort should be made to allocate less value to it and more value to assets which can be depreciated. Allocation to depreciable assets is favored even though that in the event these assets which have been depreciated

¹²Sommerfeld, Decisions, p. 169.

are sold, much of the gain may be realized as ordinary income.¹³ The deductibility of depreciation expenses creates a higher cash flow with which to help service company debt. In the case where the holding company expects to sell some of the assets of the acquired dealership in the near-term (as in a change of location, etc.), it may be wise to view the allocation from a more capital gains oriented perspective. A further point to be considered on the allocation problem extends to installment purchases. The buyer should try to get as much of each allocation as possible to be viewed as interest payments since they are deductible to the buyer. The seller on the other hand may be interested in making most of the installment price into the principle rather than interest in order to allow him to recognize capital gains rather than any ordinary gains resulting from interest income.

The New Dealership

While acquiring an existing dealership, the holding company can rely on the historical data of the

¹³Ibid., pp. 178-180.

dealership as well as the holding company's own marketing data, but in starting a new dealership at a new location, the company must rely exclusively on its marketing research data. It must use a program of marketing research to postulate as closely as possible the sales and profit potential of the prospective area without any help from historical data or experience in that area. Therefore, the research must be more extensive than that which would be undertaken in acquiring an existing dealership. As much data as possible must be formulated into the decision-making process. The decision should be made along the same procedure that was previously recommended for the acquisition of existing dealerships including both marketing and financial analysis. In establishing a new dealership, there are no existing assets or dealer goodwill meaning that any accomplishment must start from scratch. This task may be more difficult than initiating a successful operation from an acquired existing dealership; therefore, this type of move should be examined extremely carefully. In the acquisition and operation of an existing dealership, the company can be relatively confident that it will do no worse than the acquired dealership would have done in the

future. But in establishing a new dealership without the aid of historical data, the risk is made greater because the decision to initiate operations was made with less factual information.

Integration

Integration of new dealerships into the holding company system must be carefully planned. In this type of organization though, it should not be difficult. The expansion will be of a horizontal rather than a vertical nature. Thus, there is little required timing coordination to be developed as would be necessary in a vertical integration. Proper attention must be paid to involving the new dealership in the services the holding company provides. The dealership must also be integrated into the planning process in order to be a working part of the financial and sales organization. The person installed as general manager of the dealership must become involved in the board's decision process on a gradual basis as quickly as possible. Since the dealership fits into the structure horizontally, this would basically be all the integration process that is required.

Conclusion

By creating a holding company system of dealerships, it is possible to overcome the barriers and problems which present themselves to automobile dealers with relatively small sales volume potential. Those problems and barriers include General Motors' regulations and the difficulties of successful small business operation. The holding company concepts presented provide a viable solution. By carefully structuring and administering the company, a successful operation providing the proprietor with acceptable financial rewards can be attained. The benefits which were not available to small dealerships before can be within their reach with this holding company concept.

A P P E N D I C E S

A P P E N D I X I

Mention should be made of the relationship between the dealer-owner and the dealer-operator. The dealer-operator being a minority stockholder (25%) stands to lose the position in which he has invested a great deal of his own time, energy, and money. Without a formal written agreement between the two parties, any type of contingency could disrupt the relationship and cause the dealer-operator irreparable harm. Even in the case of an owner-operator relationship where the two are blood relatives, there should be a formal written contract since there can easily be a "falling out" between them.

The agreement should be composed by the parties and checked for legal validity. The form of the contract can vary, but the content should be consistent. The operator desires to maintain his position in order to have a greater degree of control of his investment, to maintain job security, and to attain the potential financial rewards available from holding the position. Sections of the contract should contain provisions pertaining to the above requirements. Among the specifics to be included

in the agreement is the issue of job security. The operator should obtain an agreement which covers his lifetime if that is desired. It should be agreed that for as long as the holding company remains in business, he will remain as dealer-operator. Further, it should be agreed that if the business is dissolved, he will be named as successor dealer on a General Motors Corporation successor addendum in order to remain as dealer-operator. He should also be a proposed new dealer-operator on the successor addendum in order to allow him a chance to maintain or increase his financial participation. In addition, the operator should make an effort to attain compensation benefits in case the dealership was terminated and he could not remain as an operator or owner. By including these items in an agreement, the operator can be in a more desirable position than otherwise possible.

A P P E N D I X 2

To better display the ideas presented in this report the following example of an automobile dealership operation and applicable holding company concepts is supplied. The data used in the example is actual data from two small town (population under 10,000) dealerships. The data is disguised as are the names and locations of the dealerships. The dealerships will be identified as Dealership 1 and Dealership 2.

Assume that the owner of Dealership 1 desires to take over Dealership 2 and in doing this takes advantage of the holding company concepts presented in this report. In this example, Dealership 1 is operating as a partnership; so the first step taken should be to incorporate the dealership in order to take advantage of the benefits outlined in the report. Since Dealership 2 is already a corporation, no change in its business form would be necessary. The corporation should be set up under Section 1244 of the Internal Revenue code as a sort of "no cost insurance" described in the text. Capital stock would be issued to the partners for the investments they have in the partnership in the same proportions as the partner's investment.

The majority partner would become chairman of the board of the holding company and president of each corporation. He would be classified as both a dealer-owner and a dealer-operator. The two minority stockholders could be classified in the same manner. A general manager should be appointed to each dealership. These should probably be the two minority stockholders.

The tax effect on these two dealerships would be favorable as described in the report. The partnership has three partners with a 50 percent-25 percent-25 percent investment arrangement. The majority partner, assuming no other income, would be taxed on 50 percent of the profit for 1975 of \$225,434.00, which comes to a \$112,717.00 share. This would put him in the 60 percent income tax bracket while if the business were incorporated he would be subject only to the maximum tax on earned income assuming he received his share as a salary. Further, any funds reinvested in the business would not be taxed as they would have been in the partnership. Even further tax benefits in the form of fringe benefits would be available due to incorporation. The companies in the example offer as their only benefits accident and life insurance policies. None of the other fringe benefits mentioned in the

report can be taken advantage of in the present partnership form.

The proprietor must also be aware of the benefits of transferability of ownership interest that incorporation would bring. He currently has over \$432,000 invested in the partnership alone. Since he would have to dispose of the assets individually as a partner, he loses the ability to dispose of his investment. By incorporating, he would own shares of stock which are easily valued and sold, given away, or willed to heirs.

The debt/equity decision must be based to a large extent on expected levels of new car sales. When consulting the sales manager of Dealership 1, an almost certain 10 percent rise in new car sales could be expected for both dealerships involved. A corresponding rise in earnings should then occur. Using the formula presented in the text, the indifference point where the amount of earnings before interest and taxes which earns the same amount on equity capital no matter the debt/equity ratio equals \$40,320 (given an 8% interest rate). Assuming the expected 10 percent rise in earnings for 1977 over the 1976 earnings of \$279,466.80, the indifference point would be exceeded by \$239,146 ($\$279,466 - \$40,320$). Thus,

expected earnings are over 3.75 times the indifference point. A great deal of debt could be taken on by the firm with little risk of not being able to service it. For example, a 25/75 debt/equity ratio could be taken on resulting in \$10,080 in interest charges (at 8%). If earnings decreased to zero and the fixed interest payments were met, a loss of only \$.02 per equity dollar would occur. Furthermore, even less risk would result since when a dealership incurred cash problems, it could take advantage of the holding company structure to borrow money from a sister dealership.

The proprietor should acquire the real estate and fixed assets and enter into the type lease agreement with the dealerships described in the text. The tax savings should be worthwhile considering the proprietor probably has enough outside income to place him in an income tax bracket of over 65 percent. The benefits of more control over the dealership could also be attained in this manner.

The company should also set up a captive finance company to increase the selling power and the income of the dealerships. The dealerships in question had a combined finance income of only \$2,608 on sales of 720 new

units and 912 used units. Thus, there is ample room for improvement. By taking advantage of financing a selected group of customers, a significant rise in income could be effected. The sales manager of Dealership 1 estimates that between 85 percent and 90 percent of the units sold are financed. Given this estimate, the captive finance company could restrict itself to financing the safest 30 percent of the customers and reap substantial profits. Given the income and expense figures in the text, finance income could be increased up to approximately \$70,000 with only a slightly increased risk factor.

Personnel costs for the dealerships would not be forced to rise. A look at the comparative statements shows the personnel costs per new unit sold to be higher for these small dealerships than for larger dealerships (see Table 3). By redistributing the workload and putting some of the excess workers into holding company jobs, the larger workload brought on by the holding company could be handled. Further increases in size could then also be handled in the same manner. Computer use as discussed in the text could become practical and reduce costs and increase efficiency even more.

The inventory control function could also be vastly improved. Only the items which move on a daily

basis need be stocked by both dealerships. Total parts and accessories inventory for the two dealerships amounted to \$290,238. This amount could be substantially reduced allowing the funds involved to be invested elsewhere more profitably. Analysis of inventory records will allow the parts to be classified in this nature.

In the same manner as other services could be used more efficiently, so could the advertising expenditure (same ads used jointly), supply expenditure (fewer duplications of work), new car inventory (more model coverage with no added investment), and body shop investment and expenses (could conceivably consolidate this part of the shop into a single unit).

The holding company concept as applied to these dealerships can, as has been shown, be a very valuable tool in an effort to expand business and increase profits. Any small dealership with expansion capital available would do well to consider this approach.

[illegible]

Dealer Sales and Service Agreement

FOR

BUICK MOTOR VEHICLES

AGREEMENT, effective the _____ day of _____,
by and between General Motors Corporation, hereinafter called General Motors, and

an individual
a co-partnership
a corporation, incorporated in the
State of _____

} of _____ City _____ State _____

hereinafter called Dealer.

GENERAL PURPOSE OF THIS AGREEMENT

The marketing plans followed by the Car and Truck Divisions of General Motors involving the sale of cars and/or trucks to and by the dealers they franchise, and the performance of service thereon, have as their primary objective, and the mutual objective of each such Division and of all such dealers must continue to be, the fulfilling of a basic public need — the need for individual transportation.

It is the responsibility of Buick Motor Division of General Motors to market Buick motor vehicles. Throughout this Agreement the term "Buick" shall mean Buick Motor Division of General Motors.

The success of Buick and each Franchised Buick Dealer depends importantly upon how well they each fulfill their respective responsibilities. It is recognized that General Motors will endeavor to design and manufacture quality motor vehicles that offer attractive values to purchasers; that Buick will endeavor to establish franchised dealers in such numbers and at such locations as will provide effective sales and service effort at the retail level, convenient service for owners of the motor vehicles marketed by Buick, and adequate sales and service opportunities for each franchised dealer; and that each franchised dealer must fulfill its functions and responsibilities through aggressive, sound and ethical selling practices and through conscientious regard for customer service.

The success of Buick and of Franchised Buick Dealers is mutually dependent. The success of each is affected by the efforts and success of the other. Effective marketing and servicing of Buick motor vehicles involves cooperative effort and a close relationship between Buick and each Franchised Buick Dealer in fulfilling the sales and service needs of customers and owners.

If Dealer has been granted franchise and related rights under other Dealer Sales and Service Agreements covering other makes of General Motors motor vehicles, only one of the Divisions of General Motors will have responsibility for administering certain provisions of this Agreement and such other Dealer Sales and Service Agreements. The Division of General Motors having such responsibility will be designated to Dealer by Buick or by such other Division and, with respect to such provisions, the term "Buick" as used in this Agreement shall mean either Buick or such other Division, as the case may be.

It is the responsibility of General Motors Parts Division to market and distribute and to administer, together with Buick, the provisions of this Agreement relating to General Motors Parts and Accessories, and throughout this Agreement the term "GM Parts" shall mean General Motors Parts Division of General Motors.

This Agreement establishes Dealer as a Franchised Buick Dealer and sets forth the basic ground rules and procedures that will apply to the franchise relationship and to the business transactions that will be conducted by Buick and Dealer. In doing so, it sets forth the Franchise and Related Rights that Dealer will enjoy as one of the Franchised Buick Dealers selected by Buick to market and service specified Buick motor vehicles; the responsibilities that Dealer assumes in consideration of such Franchise and Related Rights; and the respective conditions, rights and obligations of Buick and Dealer that are applicable to Buick's grant to Dealer of such Franchise and Related Rights and Dealer's fulfillment of such responsibilities.

For consistency and clarity in presenting the provisions of this Agreement, frequently used terms have been defined in Article I of this Agreement and are employed throughout the Agreement and in the Addenda, Manuals, Bulletins and other documents referred to herein. Reference should be made when necessary to such definitions for a proper understanding of provisions in which they appear.

NOW, THEREFORE, in consideration of the foregoing and the promises hereinafter made by the parties to each other, it is hereby mutually agreed:

FIRST: Franchise and Related Rights

(a) Grants by Buick

Subject to the conditions and provisions set forth in this Agreement, Buick hereby

(1) grants Dealer a franchise to conduct the complete Dealership Operations contemplated under Section A of Article III of this Agreement at and from the Dealership Locations and Dealership Premises described and established in accordance with the provisions of Section B of Article III of this Agreement;

(2) grants Dealer a non-exclusive right to buy and undertakes to sell to Dealer on a non-exclusive basis new Motor Vehicles and Parts and Accessories, subject to and in accordance with the provisions of Article II of this Agreement, for resale or for rental or lease by Dealer in its conduct of the Dealership Operations; and

(3) grants Dealer a non-exclusive right, subject to and in accordance with the provisions of Section G of Article III of this Agreement, to identify itself as a Franchised Buick Dealer and to display, in the conduct of the Dealership Operations, the various trademarks and service marks, and the several other word and design marks that General Motors uses in connection with or applies to Motor Vehicles, Parts and Accessories.

(b) Acceptance and Acknowledgments by Dealer

Dealer hereby accepts from Buick the Franchise and Related Rights and, in doing so, acknowledges that:

(1) General Motors and its subsidiaries have reserved to themselves the right and freedom to franchise entities they have selected and approved to conduct dealership operations in connection with the products they market and to contract with such entities in connection therewith;

(2) Buick has not conferred upon Dealer or its management or owners the right to grant, transfer, assign or sell the Franchise and Related Rights or this Agreement to any third party, whether separately or in connection with any sale of the assets of or ownership interests in Dealer, and neither the Franchise and Related Rights nor this Agreement are transferable, assignable or salable by Dealer;

(3) No franchise fee or monetary consideration has been paid by Dealer to Buick for the Franchise and Related Rights or this Agreement and no property right or interest, direct or indirect, therein is sold, conveyed or transferred to Dealer under this Agreement; and

(4) The Franchise and Related Rights are of value and benefit to Dealer only as they relate directly, and they are applicable solely, to Dealer's conduct of the Dealership Operations while this Agreement shall continue in effect in accordance with its provisions; they have no separate, intrinsic value to Dealer apart from their application to the conduct by Dealer of the Dealership Operations; and, upon any attempted sale, transfer, or assignment thereof by Dealer, they will cease to have any value to Dealer and shall have no value or applicability to any purported purchaser, transferee or assignee thereof.

SECOND: Assumption of Responsibilities by Dealer

In consideration of the grant to Dealer of the Franchise and Related Rights and subject to the other conditions and provisions of this Agreement, Dealer hereby (a) undertakes to establish and maintain complete Dealership Operations in accordance with the provisions of Section A of Article III of this Agreement, and (b) assumes, in connection therewith

(1) Responsibility for establishing and maintaining, at the Dealership Locations, Dealership Premises in accordance with the provisions of Section B of Article III of this Agreement;

(2) Responsibility for actively and effectively selling at retail and promoting the purchase and use of new Motor Vehicles in accordance with the provisions of Section C of Article III of this Agreement; and

(3) Responsibility for servicing Motor Vehicles in accordance with the provisions of Section D of Article III of this Agreement.

Dealer acknowledges that Buick has selected Dealer as a Franchised Buick Dealer and has granted it the Franchise and Related Rights in reliance upon the undertaking of Dealer, and not of any third party or parties, to fulfill the responsibilities herein described and that, therefore, Dealer may not transfer, assign or delegate any such responsibilities to any third party or parties.

THIRD: Management and Ownership**(a) Reliance of Buick upon Dealer, Dealer Operator(s) and Dealer Owner(s)**

Buick has selected Dealer as a Franchised Buick Dealer, has granted Dealer the Franchise and Related Rights and has entered into this Agreement

(1) based on Dealer's representations to Buick relating to its business organization and financial structure and its capability and willingness to fulfill the responsibilities assumed by Dealer under Paragraph SECOND of this Agreement; and

(2) in reliance upon the agreement of Buick and Dealer that:

(i) the following named person(s) shall be, as indicated opposite their respective name(s), the Dealer Operator(s) of Dealer and/or the Dealer Owner(s) of Dealer for purposes of this Agreement:

Name	(Fill in "Yes" or "No" under both columns as applicable)	
	Dealer Owner	Dealer Operator
_____	_____	_____
_____	_____	_____
_____	_____	_____

(ii) the Dealer Operator(s) shall have and will actively exercise, in the management positions for each described in the Management and Ownership Addendum, full managerial authority for the operating management of Dealer, and

(iii) the Dealer Owner(s) will each continue to own, both of record and beneficially, the percentage of the ownership interests in Dealer shown in the Management and Ownership Addendum, and the only other person(s) that will have any record or beneficial ownership interests in Dealer shall be the person(s) who have been approved by Buick for such ownership and who are named as Other Owner(s), together with their respective percentage of ownership interests in Dealer, in the Management and Ownership Addendum.

Buick and Dealer will execute, as of the effective date of this Agreement, a Management and Ownership Addendum, on a form furnished by Buick, which shall set forth the information hereinabove specified.

(b) Continuation of Agreement Conditioned Upon

It follows from the provisions set forth in subparagraph (a)(2) above that this Agreement shall be construed as being in the nature of a personal service agreement. Dealer acknowledges and agrees that, except as otherwise provided in this Agreement, Dealer may continue to enjoy the benefits to be derived from the Franchise and Related Rights only so long as Dealer is, and continuation of the business relations between Buick and Dealer established by this Agreement are conditioned upon Dealer being, managed and owned as provided herein.

(c) Changes Agreed Upon by Dealer and Buick

Dealer shall give Buick prior written notice of any change it desires to make in the management or ownership of Dealer as reflected in the Management and Ownership Addendum. Any such change that may be agreed upon by Buick and Dealer shall be reflected only by the execution by Buick and Dealer of a new and superseding Management and Ownership Addendum and, if there is a change in any Dealer Operator or Dealer Owner, by the execution of a new and superseding Dealer Sales and Service Agreement or an appropriate amendment of subparagraph (a)(2)(i) of this Paragraph THIRD.

FOURTH: Additional Provisions

The additional provisions set forth in the attached "Additional Provisions Applicable To Dealer Sales and Service Agreement," bearing Form No. S-451-75, are hereby made a part of this Agreement with the same force and effect as if set forth at length herein.

Dealer acknowledges, in connection therewith, that the provisions of Section C entitled "Termination Assistance Relating to Eligible Items of Personal Property," of Section D entitled "Termination Assistance Relating to Dealership Premises," and of Section E entitled "Establishment of Successor Dealer Proposed by Remaining and/or Proposed Dealer Operators" of Article IV of this Agreement are included by Buick in such Additional Provisions because Buick, in the exercise of its rights relating thereto, has selected and approved Dealer as a Franchised Buick Dealer.

FIFTH: Term

This Agreement shall have a term commencing on the effective date hereof and, subject to its earlier termination in accordance with the provisions of Article IV of this Agreement, expiring on _____ Subject to other applicable provisions of this Agreement, this Agreement shall automatically terminate at the end of such stipulated term without any action by either Dealer or Buick.

SIXTH: License of Dealer

If Dealer is required to secure a license for the conduct of the Dealership Operations in any state or jurisdiction where the Dealership Operations are to be conducted, this Agreement will not be valid until and unless Dealer shall have furnished Buick with written notice specifying the date and the number, if any, of such license issued to Dealer. Dealer shall notify Buick immediately in writing if Dealer shall fail to secure or maintain such license or a renewal thereof or if such license is suspended or revoked, specifying the effective date of any such suspension or revocation.

SEVENTH: Execution on Behalf of Buick and Dealer

Neither this Agreement nor any Addendum thereto shall be valid until and unless it bears the signature or facsimile signature of the General Sales Manager and, when space for countersignature is provided for thereon, is countersigned by either an Assistant General Sales Manager, a Regional Manager or a Zone Manager of Buick Motor Division, General Motors Corporation, provided, however, that if Dealer has been notified that another Division of General Motors will have responsibility for administering any provision of this Agreement that requires the execution of an Addendum to this Agreement, such Addendum when so executed by such other Division shall be deemed to have been executed on behalf of Buick and to be a part of this Agreement; nor shall this Agreement or any Addendum thereto required to be executed by Dealer be valid until and unless it is signed on behalf of Dealer by one or more duly authorized officers of Dealer if Dealer is a corporation, or by one or more general partners of Dealer if Dealer is a partnership, or by Dealer if Dealer is a proprietorship.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement in triplicate as of the day and year first above written.

Dealer Firm Name

By _____
Signature and Title

By _____
Signature and Title

Witness: _____

GENERAL MOTORS CORPORATION
Buick Motor Division

By *R. D. Burger*
General Sales Manager

By _____
Manager

B I B L I O G R A P H Y

B I B L I O G R A P H Y

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Martha Ann Zivley typing service

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